Story of How Great Tobacco Combination Was Formed; How Competition in the World's Trade Was Throttled

Below is given a comprehensive summary of the first division, Part I, of the report of Commissioner of Corporations Herbert Knox Smith, on the tobacco industry, submitted by the commissioner to the President yesterday. The report deals with the history of the organization of the great combination which practically controls the tobacco trade of the world; it tells a story that will be astonishing to those uninformed on the subject, and gives interesting facts and figures in compact, readable form, concerning which the public at large has known only through rumor.

While this is the first of three parts of the complete report, it gives such a complete history of the formation of the combination and such a clear insight into its present organization and operations, that it is vastly more interesting to the public than the sections that are to follow.

The summary follows:

1. History of the Tobacco Combination.

"The Tobacco Combination has as its center the American Tobacco Company. This company controls three great subsidiary combinations—the American Snuff Company, the American Cigar Company, and the British-American Tobacco Company. The American Tobacco Company and the other three combinations each control a large number of subsidiary companies. The number of companies in the Combination doing business in the United States, Porto Rico, and Cuba is 86, besides a considerable number operating only in foreign countries.

The Tobacco Combination dominates the tobacco industry of the United States. With the exception of cigars, its proportion of the country's output of manufactured tobacco products is substantially four-fifths, giving it a large degree of monopoly power.

The magnitude of the Combination is further shown by its enormous capitalization. The said 86 companies have an aggregate capitalization including bonds, of $450,395,890. A considerable part of this, however, represents duplication through intercompany ownership of securities. The net amount of the stock and bonds of the companies in the hands of the public (including the directors and all holders except the companies themselves), however, is no less than $316,346,821.

The present report deals with the position of the Tobacco Combination in the industry, and includes a history of the Combination, a description of its organization, plants, and business, and an analysis of its control of the industry. Reports to be published later will deal with the effect of the Combination upon the prices of tobacco, with its profits and the relation thereof to its capitalization, and with the competitive methods pursued by the Combination.

"The history of the Combination begins with the organization of the American Tobacco Company in 1890. This was a combination of the five principal manufacturers of cigarettes (Allen & Ginter, W. Duke, Sons & Co., Kinney Tobacco Company, Wm. S. Kimball & Co., and Goodwin & Co.) and its business at first was confined substantially to cigarette manufacture. The company started with a capital of $10,000,000 of preferred stock and $15,000,000 of common stock—an amount vastly in excess of its tangible assets, which were $5,000,000 (including $1,825,00 in the form of notes of the individual stockholders). James B. Duke was made president, and from that time to this he has been president of the leading companies in the Combination and has largely directed its policy.

"The American Tobacco Company at its inception secured control of over 90 per cent of the cigarette business of the country. It sought to maintain this dominant position partly by making agreements for the exclusive use of what were considered the best cigarette machines; the most important of these agreements, however, was terminated in 1895. During this period, 1890 to 1895, the average profits of the company were very large, exceeding four million dollars annually.

Plug-Tobacco War, 1894 to 1897

"The American Tobacco Company early began to extend its domination to cover other branches of the tobacco industry. In 1891 the authorized capital was increased to $25,000,000, $6,000,000 of this increase was common and $4,000,000 was preferred. In this year the company bought two important concerns manufacturing smoking tobacco and snuff, another manufacturing plug chewing tobacco, and a fourth which was the principal manufacturer of cheroots in the United States. During the period from 1894 to 1897 it developed its plug-tobacco business with such a degree of success that ultimately its leading competitors in that branch were forced into combination with itself.

"In pursuit of its policy of expansion the American Tobacco Company, particularly after 1894, sold plug tobacco at greatly reduced prices. Its leading fighting brand bore the appropriate name of "Battle Ax." At one time this brand was sold to jobbers as low as 13 cents per pound, which, considering the revenue tax, was below the cost production. The company's immense profits from its cigarette business furnished the means for conducting this expensive competitive struggle, in which several millions were sacrificed. The American Tobacco Company's plug business increased swiftly, and by 1897 it had more than one-fifth of the total plug output of the country. To enable the company to fill its orders an additional plug plant was purchased in 1895, and another erected.

"By 1898 a number of the leading independent manufacturers of plug tobacco had wearied of the fierce competitive struggle and were prepared to consider a proposition for combining their interests with those of the American Tobacco Company. The first negotiations, early in 1898, were however, unsuccessful, partly by reason of the increase in taxes during the Spanish-American war, which appeared to the financiers who were promoting the enterprise likely to interfere with its profitableness. Shortly thereafter the American Tobacco Company bought outright two important plug-manufacturing concerns—the Brown Brothers and Drummond tobacco companies, of St. Louis. This greatly strengthened the position of the American, and it apparently determined to renew the vigorous competition of the preceding years against its powerful rivals. For this purpose the price of "Horseshoe," the leading brand of the Drummond concern, was sharply reduced.

"Before this new competitive fight had become very active, however, further negotiations for combination began. The plug combination known as the Continental Tobacco Company, was organized on December 10, 1899. It took over the plug business of the American Tobacco Company, including the Brown and Drummond concerns, and also that of six leading competitors, while a few months later the most important competitor of all, the Liggett & Myers Tobacco Company, was also brought into the Combination. Several of the concerns acquired had also a large business in smoking tobacco. Although the American Tobacco Company did not at that time own a majority of the stock of the Continental Tobacco Company, the men connected with the American were, from the very first, dominant in the Continental's directorate.

"The Continental Tobacco Company issued at the time of its organization $62,290,700 of stock. This amount was still further increased in April, 1899, by reason of the acquisition of the Liggett & Myers concern. The total issue then became $49,944,600 of preferred stock and $48,846,100 of common stock, or $97,690,700 altogether, an amount which thereafter remained unchanged. The company was greatly overcapitalized, the common stock being issued wholly as a bonus.

"The acquisition of the Liggett & Myers Tobacco Company by the Continental, just referred to, was part of a series of transactions which had a most important influence upon the personnel of both the American and Continental tobacco companies. During 1898 a group of powerful financial interests, including Thomas F. Ryan, P. A. B. Widener, A. N. Brady, W. C. Whitney and Thomas Dolan, bought up the Blackwell's Durham Tobacco Company, an important manufacturer of smoking tobacco, and the National Cigarette and Tobacco Company, combining them under the name of the Union Tobacco Company. They also secured an option upon a controlling portion of the stock of the Liggett & Myers Tobacco Company, control of which of course was very important to the new plug combination. Mr. Duke and his associates in the American and Continental companies realized the seriousness of the possible competition of the Union Tobacco Company interests, backed by these wealthy financiers. They therefore entered into negotiations with these financiers and bought out the properties they controlled at a high price. Early in March, 1899, the assets of the Union Tobacco Company proper were taken over by the American Tobacco Company in exchange for $12,500,000 common stock. Shortly afterwards, through another syndicate, composed in part of the men above mentioned, but also including J. B. Duke, O. H. Payne, and H. D. Terrell, the Liggett & Myers Tobacco Company assets, together with $5,000,000 in cash, were transferred to the Continental Tobacco Company in exchange for $17,500,000 of its common stock and $17,500,000 of preferred stock.

"These transactions were important not only because they still further inflated the capitalization of the two companies, but because they resulted in giving a very large stock interest in both to the financiers who had organized the Union Tobacco Company. Most of these men shortly thereafter entered the directorate of either the American or Continental company, or both, and from that time on have been important factors in the control of the entire Tobacco Combination.

"Already before this time there had been marked changes in the directorate of the American Tobacco Company. The campaign for control of a larger part of the tobacco industry, which has just been recounted, had not been favored by most of the leaders in the original cigarette combination. Consequently, Ginter, Kinney, Kimball, and Emery (owner of Goodwin & Co.) had practically disposed of their interests in the American Tobacco Company by the spring of 1898. Indeed, none of them was a director in that company after the spring meeting of 1897.

"This defection of most of the large stockholders among those who had organized the original Combination found other men, possessed of large capital but without previous experience in tobacco manufacture, ready to avail themselves of the opportunity offered. During the latter part of 1897 and early in 1898 Oliver H. Payne and H. L. Terrell invested freely in stocks of the American Tobacco Company and were elected directors. At about this time Moore & Schley, New York bankers and brokers, also established close relations with the Combination. They financed the organization of the Continental Tobacco Company. These new men, together with those who entered the management as the result of the Union Tobacco Company transaction, have had a powerful influence in the subsequent expansion policy of the Combination, both by furnishing capital and in other ways.

"At the time of the purchase of the Union Tobacco Company the American Tobacco Company paid, out of its accumulated surplus and the profits of the sale of its plug business to the Continental, a stock dividend of 100 per cent, or $21,000,000 to its common-stock holders. This, with the stock issued for the Union, added $33,500,000 to the company's capital stock and almost doubled the capitalization already existing. From this time on until 1904 the capitalization of the American Tobacco Company consisted of $54,500,000 of common stock and $14,000,000 of preferred stock.

Snuff Combination.

"Within a short time after the organization of the Continental Tobacco Company the combined interests obtained control of practically all the leading snuff concerns of the country. Ever since 1891 the American Tobacco Company had had a small snuff business. The Continental had acquired the extensive snuff business of the P. Lorillard Company, and in 1899 the American Tobacco Company acquired two or three additional snuff concerns. The two companies together had at the beginning of 1900 substantially one-third of the snuff business of the country. About two years before this, however, a combination of the important strong Scotch snuff-manufacturing concerns of the country had been effected independently of the American and Continental interests, under the name of the American and Continental interests under the name of the Atlantic Snuff Company. The output of this concern was greater than that of the Continental interests, under the name of the Atlantic Snuff Company. The output of this concern was greater than that of the Continental and American together. During 1899 a vigorous competitive warfare was conducted between these two groups of interests. Early in 1900, however, they came together in the formation of the American Snuff Company, which also took in another important concern, the George W. Helme Company.

"The American Snuff Company was organized on March 12, 1900. It issued $12,000,000 of 6 per cent preferred and $11,001,700 of common stock.

Control of the Industry in 1900.

"The organization of the Continental Tobacco Company, the American Tobacco Company's acquisition of the Union Tobacco Company and of other concerns in 1899, and the formation of the American Snuff Company at once raised the Tobacco Combination to a dominant position in the manufacture of all the important kinds of tobacco except cigars. In 1900 the Combination had 62 per cent of the national output of plug tobacco and 59.2 per cent of the output of smoking tobacco. In 1901, the first full year of the American Snuff Company it had 80.2 per cent of the output of snuff. In 1897 the American Tobacco Company had controlled barely a fifth of any one of these products. The Combinatoin, moreover, still retained substantially a monopoly control over the cigarette business, making 92.7 per cent of the national output in 1900.

Cigar Combinatoin.

"Last of all the Combination turned its attention to the cigar business, the most important of all the branches of tobacco manufacture, but also the most difficult in which to make an effective combination, because of the immense number of concerns in the trade.

"Since 1891 the American Tobacco Co. had had a considerable business in the manufacture of cheroots, but had made no ordinary cigars. Soon after the organization of the Continental Tobacco Company, however, the American began plans to enter the cigar business. Inasmuch as it had found that its position in the cigarette business had been greatly strengthened by the control of machine patents, it began experimentation with machines for making cigars. Up to the present time, however, machinery has become of comparatively little importance in the manufacture of any but the cheaper types of cigars. Nevertheless, the American Tobacco Company interests in 1901 entered extensively into the cigar business by the organization of the American Cigar Company.

"This company, incorporated January 12, 1901, started with an authorized capital stock of $10,000,000, of which $9,965,000 was issued. The Continental and American tobacco companies each took $2,500,000 of the stock. Soon afterwards $10,000,000 of ten-year gold notes were issued by the American Cigar Company, guaranteed by the same two companies.

"The American Cigar Company took over the greater part of the cheroot and small-cigar business of the American Tobacco Company, and proceeded to buy up a number of existing cigar-manufacturing concerns.

"The acquisitions made by the American Cigar Company in 1901 immediately made it the largest single manufacturer of cigars in the country, but it did not then possess and has never since possessed any large proportion of the total cigar business of the United States. During the year 1901 to 1903, however, it greatly increased its output, though only at the expense of heavy losses, due to extravagant advertising and schemes and deals in connection with the American and Continental companies. In 1903 it had about one-sixth of the cigar output of the United States.

"The new capital made available by the Consolidated Tobacco Company, which was organized soon after the American Cigar Company, was in part used in this expansion of the cigar business.

Consolidated Tobacco Company, 1901.

"The Consolidated Tobacco Company, organized in June, 1901, still further cemented the union between the two principal combinations—the American and Continental companies—by acquiring nearly the entire amount of the common stock of both. The Consolidated also gave still more complete control to the few men who were already the leaders in the management and gave them the surplus profits of the business. An immediate object, however, was to secure additional capital for the expansion of the business of the Combination, particularly in the cigar industry and in foreign countries.

"The Consolidated Tobacco Company had at the outset a capital stock of $30,000,000, which was paid in in cash; this was increased to $40,000,000 at the end of 1902. Immediately after its organization the Consolidated issued a circular, giving the names of its directors, who were mostly men already in the directorates of the other two companies, and offering to exchange its 4 per cent bonds in equal amounts for the common stock of the Continental Tobacco Company, and to exchange them at the rate of $200 for $100 for the common stock of the American Tobacco Company. The offer was promptly accepted by nearly all the stockholders. Ultimately the amount of bonds issued by the Consolidated for this purpose became $157,378,200, for which $54,274,559 of American and $48,829,100 of Continental common stock were acquired. The exchange of a double amount of bonds for the American Tobacco Company stock meant, of course, a still larger overcapitalization as compared with the actual investment.

"The owners of the stock of the Consolidated thus acquired effective control of both the American and the Continental, and became entitled to all the profits of both in excess of the fixed amounts required for dividends on their preferred stocks and for interests on the Consolidated bonds. This exchange of stock for bonds had appeared at the time highly advantageous to the common-stock holders of the American and Continental companies. The Continental common stock had never paid a dividend, and during much of the time had sold at between $20 and $30 per $100 share; the holders were now guaranteed 4 per cent on the par value. The American Tobacco Company's common stock, since the declaration of the 100 per cent stock dividend in 1899, had paid only 6 per cent, and the exchange was equivalent to a guarantee of 8 per cent. The actual earnings of the company were about 9 per cent.

"Nevertheless, the transaction actually proved enormously profitable to the men who organized the Consolidated Tobacco Company. Those men had been for the most part in the directorates of the American and Continental companies, and they were in a far better position than most outside stockholders to form a correct judgment as to the probable great increase in profits that was likely to occur in the near future.

"The probability of such an increase in profits lay in the changes in the internal-revenue taxes on tobacco products. Those taxes had been greatly increased in 1898, to provide funds for the Spanish war. Already, before the organization of the Consolidated, Congress had passed an act to reduce the tax on "manufactured tobacco" (i. e., chewing and smoking tobacco) and snuff from 12 cents to 9.6 cents per pound and that on cigarettes from $1.50 to $1.08 per thousand (54 cents for cheap grades). This reduction was to take effect on July 1, 1901, or a few weeks after the Consolidated was established. Presumably, also, the directors of the concern foresaw that the tax on manufactured tobacco and snuff would be still further reduced later, to bring it back to the basis which had existed before the war. This actually occurred in 1902, when it was made 6 cents. When the tax had been advanced, the manufacturers of tobacco had barely been able to raise prices sufficiently to recoup themselves, but the men connected with the Consolidated evidently foresaw that prices would not have to be reduced by an amount at all commensurate with the reduction in the tax—particularly in view of the large proportion of the business now possessed by the Combination and its consequent large measure of control over prices—and that consequent profits would be increase.

"Such is believed to be the case. On the basis of the rate of earnings of the American and Continental prior to the formation of the Consolidated, it would scarcely have been possible to pay dividends on their preferred stocks and interest on the Consolidated bonds. During the three years and four months following the organization of the Consolidated, however, the earnings of the two companies were sufficient to pay those charges and also to leave a profit of fully $30,000,000 (part of the time $40,000,000). That company during this period of time paid $6,000,000 in dividends, accumulated a surplus of $17,000,000 and substantially became entitled also to the increase in the surpluses of the American and Continental companies, amounting to over $7,000,000.

"The benefit of this increase in profits was, by reason of the organization of the Consolidated, largely concentrated in the hands of a few men. This is seen in the fact that immediately after the organization of the Consolidated more than half of its shares were held by six men—James B. Duke, A. N. Brady, O. H. Payne, Thomas F. Ryan, P. A. B. Widener, and William C. Whitney. Through the ownership of the stocks of the American and Continental by the Consolidated, these six men were, moreover, in position to dominate the entire Combinatoin. The same six men had just previously owned only a minority of the stocks of the American and apparently very little of the Continental, though they had been very powerful in the management of both. Most of these men, it will be observed, were the financiers who had entered the Combination in 1898 and 1899. They and a few associates had supplied the greater part of the new capital now made available for the expansion policy; but they did so only because it was evident that, through the organization of the Consolidated, they might enormously increase their power and their share in the prospective profits of the business.

"The further expansion which the new capital furnished by the Consolidated made possible, took, as one direction, the foreign trade.

"In the fall of 1901 the Tobacco Combination entered upon a campaign designed to secure it a powerful position in Great Britain. For this purpose it bought control of Ogden's (Limited), a leading English manufacturer, paying therefor over $5,000,000. The Ogden's company at once offered most liberal inducements to the trade. This entrance of the American Tobacco Company interests into Great Britain alarmed the other tobacco manufacturers there, and almost immediately as a self-protection, thirteen of the most important established a great combination—the Imperial Tobacco Company. The American and the Imperial waged a competitive warfare of extraordinary vigor for nearly a year. Toward the end of 1902, however, an agreement between the two interests was effected.

"By this agreement the American Tobacco Company and its affiliated concerns relinquished their entire business in Great Britain and Ireland to the Imperial, receiving therefor in cash and securities of the Imperial something over $8,500,000. The latter company agreed, on the other hand, not to manufacture or sell tobacco in the United States or its dependencies or in Cuba. The American and Imperial interests then joined in the organization of a third company, to exploit the tobacco business of the world outside of Great Britain and the United States. This company, the British-American Tobacco Company, was incorporated under the laws of Great Britain in 1902.

Cuban Cigar Business, 1902.

"Another direction in which expansion was now sought was in cigar manufacture. Here, too, the new capital furnished by the Consolidated was useful. Aside from the activity of the American Cigar Company in the domestic trade, already referred to, that company now undertook to secure a dominant position in the important cigar business of Cuba.

"Early in 1902 it bought two large factories at Havana, combining them under the name of H. de Cabanas y Carajah (incorporated). This company issued $1,500,000 of stock, all of which was held by the American Cigar Company. Shortly afterwards, on May 28, 1902, the Havana Tobacco Company was organized. It took over the stocks of Henry Clay and Bock & Co. and the Havana Commercial Company, two combinations which had been formed by independent interests some time before, and also that of the Cabanas y Carbajal company. The new corporation issued no less than $30,000,000 of common stock and $5,000,000 of preferred, together with $7,500,000 of bonds. The American Cigar Company received for the $1,500,00 of Cabanas y Carbajal stock $20,000,000 of common stock of the Havana Tobacco Company and $2,625,000 of its bonds. The common stock had little value, except for purpose of control, and has never paid a dividend. The Havana Tobacco Company from the outset controlled a large proportion of the manufacture of cigars in Cuba.

Merger in American Company, 1904

"The control of the Tobacco Combination continued to be exercised through the Consolidated Tobacco Company until October 19, 1904. At that time the Consolidated and its two subsidiary companies, the American and the Continental, were all merged into one company called the American Tobacco Company. This merger was prompted in part by the adverse decision of the Supreme Court of the United States in the Northern Securities case. The Consolidated Tobacco Company was purely a stockholding company, somewhat analogous to the Northern Se-

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